unison
The Powerlines People

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Commerce Commission New Zealand
Te Komihana Tehokohoko
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Tēnā koutou

DRAFT INPUT METHODOLOGIES DECISIONS 2023

1. Unison Networks Ltd (**Unison**) is a price-regulated electricity distribution business operating networks in Hawke's Bay, Rotorua, and Taupō. It is consumer-owned and part of Unison Group Limited which comprises six subsidiaries[1] that provide services or equipment to the electricity sector.

2. The Commerce Commission (**Commission**) has consulted on the Draft Input Methodologies (**IM**) Decisions, including a large volume of technical and expert information relating to its reasoning for retaining the status quo or amending the IMs. Enclosed is the first of two submissions in the consultation process.

Nāku noa, nā

Rachael Balasingam
REGULATORY MANAGER

[1] Unison Group subsidiaries and key supply chain partners:
- Unison Contracting Services Limited (UCSL) — electrical, civil and vegetation management
- contracting services, as well as 24/7 fault response
- Unison Fibre Limited — fibre network services to enable Unison's Smart Grid
- Unison Insurance Limited — captive insurance for critical assets
- ETEL Limited and LLG based in Indonesia (whom ETEL has a majority shareholding) — who
- together provide Unison with power and distribution transformers
- RPS Switchgear Limited — provides Unison with 11kV switchgear and
- PBA Limited — provide high voltage electrical services.

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EXECUTIVE SUMMARY

1. The Draft IM Decisions have acknowledged the context and uncertainty electricity distribution businesses (**EDBs**) will face in the upcoming regulatory periods. If the implementation is consistent with the policy intent, there are several draft decisions that achieve materially better Part 4 outcomes for EDBs, for example attempting to address particularly adverse impacts of inflation,[2] passing-through transmission costs, broadening the definition of innovation, and removing from the regulatory asset base (**RAB**) large connection capex of over 10MW that are agreed on commercial terms.

2. Unison, however, remains concerned with its ability to invest in decarbonisation at the pace and scale to meet consumer demand and expectations. *Energy efficiency* needs to be addressed consistent with the definition in the Energy Efficiency and Conservation Act 2000: "*a change to energy use that results in an increase in net benefits per unit of energy*".[3]

3. The Draft IM Decisions, in fact, create disincentives to invest at a critical time. The likely impact on Unison's price-path of the 10% price cap and reduced WACC percentile (from the 67th and 65th percentile) is concerning. Expert evidence commissioned by the Big 6 supports that there is a material risk of financeability constraints for the Big 6, and the incentives provided by the Incremental Rolling Incentives Scheme (**IRIS**) may be compromised because:

    a) the price limit may prevent full recovery of the efficient costs to run their businesses over an extended period; and
    b) the Weighted Average Cost of Capital (**WACC**) reduction to the 65th percentile is too low.[4]

4. The five-week turnaround for engagement and testing of novel and complex decisions has proved challenging. This heightens the risk of implementation being inconsistent with the policy intent and inadvertent and adverse consequences.

5. Two requirements of Part 4 of the Act are particularly relevant to Unison's input on the Draft IM Decisions:
    a) Section 52T(2)(a) which requires the IMs include "…*sufficient detail so that each affected supplier is reasonably able to estimate the material effects of the methodology on the supplier…*"; and
    b) Section 54Q stating that the Commission *"…must promote incentives, and must avoid imposing disincentives, for suppliers of electricity lines services to invest in energy efficiency, demand side management and, to reduce energy losses…"*.

6. This submission:
    a) summarises Unison's strategic priorities;

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[2] Through adjusting the Incremental Rolling Incentive Scheme (IRIS) to reflect real as opposed to nominal inflation (noting concerns about price volatility*).*
[3] Protected by s 54Q of the Commerce Act 1986.
[4] Than any point in the history of Part 4, see para 38 below.

b) addresses the critical context of the IM Review 2023 - mitigating the impacts of climate change and promoting affordability/'energy wellbeing';[5]
c) sets out its position on the Commerce Act 1986 (**Act**) and the statutory requirements to be resolved in the final IM Decisions;
d) seeks minimum amendments to the IMs to re-establish incentives, and remove disincentives, by:
    i) retaining the existing conservative WACC 67th percentile;
    ii) resolving the impact of the price cap on a critical investment period;
    iii) embedding financeability and equity issuance tests;
    iv) including clearer and more fulsome in-period adjustments to provide for the resolution of key uncontrollable risks; and
    v) providing certainty that the cost of a CPP will be fully recoverable in prices;
e) addresses in more detail:
    i) clarifying criteria and expanding in-period adjustments to be fit-for-purpose;
    ii) addressing limitations in the Customised Price-Quality Paths (**CPP**);
    iii) allocating risk fairly in the context:
        (1) passing-through reasonable and commercial insurance costs;
        (2) retaining the recoverability of legal costs of appealing the IMs; and
        (3) clarifying the intent and scope of the large connection capex mechanism.
f) concludes with Unison's key concerns and summarises the amendments sought.

UNISON'S STRATEGIC PRIORITIES

7. The Regulatory Asset Management Plan 2023-2033 addresses the climate change context of this next decade (discussed below), and Unison's strategy to enable electrification, network resilience, and affordability of the electricity distribution service.[6] Unison's ambition is to provide resilient solutions to its consumers, at their pace, to ensure that Unison's network does not slow down electrification in its regions.

8. The strategy's phases cover:[7]
    a) catching up on COVID and Cyclone Gabrielle related delays to work and projects (2022-2025);
    b) preparing the network to be flexible, understanding the impact of electrification, and providing sufficient capacity to support early adopters (2025-2030); and
    c) ensuring Unison builds the necessary networks and processes, to have the capability to provide sufficient network hosting capacity in the future.

9. Cyclone Gabrielle caused significant damage to Unison's network, particularly in Hawke's Bay. The flooding of Transpower's Redclyffe Substation resulted in lengthy power outages for many

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[5] It is difficult to confirm the consistent interpretation of what 'affordable' is between policymakers, presumably its ordinary meaning akin to reasonable (which leads to a subjective consideration of what is reasonable to whom). Helpfully, MBIE's report *the Energy hardship definition and measures Final report* specifies measures to assess energy hardship by.

[6] *Unison Regulatory Asset Management Plan 2023-33*, Section 1.5: https://www.unison.co.nz/tell-me-about/unison-group/publications-disclosures/asset-management-plan.

[7] Ibid, 1.5.3.

customers. In some cases, Unison's ability to restore electricity supply was delayed because of damage to other infrastructure, including roads and bridges. The loss of electricity supply impacted communications networks, impeding rescue efforts and further isolating affected communities.[8]

10. This event again highlighted the importance of infrastructure resilience in a changing climate where the frequency and severity of storms is expected to increase. It also provided a reminder of the interdependencies in community infrastructure that is provided by a range of organisations. Storm events are a key risk to overhead electricity distribution networks, and as a result have been a focus of Unison's asset management planning and investment over many years. While this has resulted in levels of network performance that consistently meet regulatory requirements, it has become clear that the network design standards applied in the past may not be appropriate to provide sufficient resilience in the future.

11. Unison takes pride in its asset management approach, including choosing to certify its practices to an international standard (ISO 55001:2014).[9] As a consumer-shareholding EDB, it is particularly engaged with meeting the needs of its consumers. There are multiple non-regulatory drivers for Unison to 'innovate, invest and operate efficiently', and promote the energy wellbeing of its communities. Unison's concern is that the resulting disincentives to invest in the Draft IM Decisions cut across those drivers to achieve the best outcomes for its communities.

12. In the next decade, Unison will make challenging investment decisions to keep up with consumer demand and expectations to efficiently provide for scenarios predicting:[10]
    a) Growth and investment in:
        i) upgrading networks;
        ii) monitoring and data (including Low Voltage (**LV**) Network Visibility);[11]
        iii) decentralising networks and digitilisation[12]; and
        iv) embedding flexibility solutions to shift demand.[13]
    b) Resilience investment in:
        i) building greater resilience into assets being replaced and upgraded by:
            (1) understanding consumer expectations for the resilience of assets vs the cost and reasonable response timeframes; and
            (2) assessing and, resolving to that standard, vulnerabilities of network and non-network services; and

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[8] Ibid, 1.5.4.
[9] *Unison Regulatory Asset Management Plan 2023-33*, Section 1.4, ISO 55001:2014 is an international standard that specifies the requirements for Asset Management Systems.
[10] As detailed in Unison's December 2022 submission to the Commission on forecasting expenditure.
[11] Ibid, 4.2.3.2 (1): *Increased penetration of distributed energy resources in the distribution network has the potential to create issues on low voltage (400 volt) circuits which traditionally have less mature levels of asset information quality and are not remotely monitored.*
[12] Ibid, 4.2.3.
[13] Ibid, 4.2.3.2 (3): Borrowing from international experiences, the term 'flexibility' is increasingly being used in New Zealand with an example being the recent Electricity Authority's consultation document. It is defined as *"modifying generation and / or consumption patterns in reaction to an external signal (such as a change in price) to provide a service within the energy system".*

   ii) collaborating on regional emergency responses to improve the impacts of climate change and natural disasters on Unison's communities.

c) Innovation and non-traditional solutions to:

   i) understand the systemic risks impacting the network;

   ii) achieve efficiencies to respond to growth and resilience; and

   iii) develop more cost-effective, less resource intensive, and 'smarter' ways of providing services to consumers.

THE CRITICAL CONTEXT OF THE IMs 2023 - CLIMATE CHANGE AND ENERGY WELLBEING

13. Ten years on from the 2013 High Court precedent on the Input Methodologies, the context surrounding the electricity market has markedly changed. The relevance of that will not be lost on the Commission - *"In law, context is everything*".[14] Climate change is a pervasive societal issue, embedded in economic, social, and environmental decisions across workably competitive[15] and regulated markets.

14. Regulated electricity suppliers (transmission and distribution) are grappling with paradigm shifts as Government and its advisers rapidly create and amend legislation, regulation, and policy on Aotearoa's path to its statutory net-zero target.[16] Electrifying Aotearoa's economy is a policy priority, fundamental to the Emissions Reduction Plan (**ERP**)[17] and National Adaptation Plan (**NAP**).[18] These plans set a pathway to achieve the Climate Change Response Act 2002, s 5Q net-zero by 2050 emissions reduction target (**net-zero target**). Consumer expectations about being able to electrify are increasing quickly. This correlates with their support of changing their energy use to achieve 'an increase in net benefits per unit of energy' (discussed further at paragraph 23).[19] Electricity suppliers have proactively committed to facilitating a future passionately supported, but substantively decided by Government and regulators.[20]

15. Affordability is much discussed in recent policy, including in the ERP and NAP. Related is MBIE's broader concept of "energy wellbeing": *"Energy wellbeing is defined as when individuals, households*

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[14] *Wellington International Airport Ltd & Ors and Vector Limited & Ors v Commerce Commission* [2013] NZHC 3289, at [104].

[15] For example, the rise of ESG obligations, climate change disclosures and legislative/regulatory mechanisms like the Emissions Trading Scheme, and consenting under the Resource Management Act 1991.

[16] Climate Change Response Act 2002, s5Q; the Commission is well aware of the s 5ZN permissive power in decision-making.

[17] A 'key action' in the Energy and Industry chapter:

Ensure the electricity system is ready to meet future needs by:

- *investigating the need for electricity market measures to support the transition to a highly renewable electricity system and investigating options for electricity storage in dry years*
- *reducing barriers to developing and efficiently using electricity infrastructure, including transmission and distribution networks;*
- *supporting renewable and affordable energy in communities through the Māori and Public Housing Renewable Energy Fund.*

[18] *Action 8.4: Provide for regulated network revenues to reflect the prudent and efficient costs of resilience.*

[19] *EECA, s 3.*

[20] In the sense that mitigating climate change is a 'public good' with international benefits.

and whānau are able to obtain and afford adequate energy services to support their wellbeing in their home or kāinga."[21]

16. The focus of this submission is consistency of the Draft IM Decisions with the legislative intent and constraints in Part 4 and ss 52A, 52R, 52T, and 54Q of the Commerce Act 1986 (**Act**). Regulation under the Act will not answer in full the challenging tensions that climate change and energy wellbeing have brought to the fore in this IM Review. To achieve the net-zero target, Government and stakeholders will need to create solutions to address gaps that regulation cannot fill.

INPUT METHODOLOGIES – PART 4

17. The Commission's summary and context paper includes the importance of 'stability and predictability' in the regulatory regime for investors of regulated 'firms' (suppliers) to *"invest in long-lived infrastructure that provides essential services to New Zealanders*".[22] The paper concludes that the IMs *"…remain broadly fit-for-purpose and flexible enough to cope with the changing operating environment"*.[23]

18. Part 4 must 'generate certain outcomes', which include:[24]

    "…the earning by firms of normal rates of return, and the existence of prices that reflect such normal rates of return, after covering the firms' efficient costs."

19. The Commission also acknowledges the critical context: [25]

    "In an environment where suppliers of electricity lines services are expected to deliver large volumes of investments in this decade to meet New Zealand's emissions targets and transition our economy, it is important that the ***pace of network growth broadly matches consumers' demand*** *for electricity lines services."*
    [Emphasis added]

20. The Draft IM Decisions include some improvements to the status quo to rectify issues (and unsatisfactory outcomes) experienced in Default Price-Path 3 (**DPP3**). However, there are methodologies in the Draft IM Decisions that do not strike the right balance under Part 4, including:
    a) reducing the Weighted Average Cost of Capital (**WACC**) from the 67th percentile to the 65th percentile;
    b) retaining uncertainty about when and how financeability concerns and costs of raising equity may be addressed;
    c) relying on the CPP mechanism as a 'backstop' to financeability concerns and the uncertainty embedded in the in-period adjustments mechanisms; and
    d) providing broad discretion to the Commission to reject an in-period adjustment because it thinks a CPP is more appropriate; and

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[21] Energy hardship has been defined subject to a series measures. MBIE, Defining energy hardship https://www.mbie.govt.nz/building-and-energy/energy-and-natural-resources/energy-hardship/defining-energy-hardship/.
[22] *Summary and context paper*, pg 5: "A stable and predictable regime provides suppliers and investors in regulated firms with the confidence to invest in long-lived infrastructure that provides essential services to all New Zealanders."
[23] *Summary and context paper*, pg Pg 6.
[24] High Court 2013 Input Methodologies merits appeal, [18].
[25] *Financing and Investment Topic Paper, X8.*

e) deciding to allocate greater risk to EDBs in specific areas.

21. Unison's feedback is that these methodologies need to be amended in the final IM decisions to achieve materially better Part 4 outcomes. There is a foreseeable increase in the Commission's workload (noting the evidence of that already with new regulated markets, and more in-period adjustment and CPP potential). Greater delegation of decision-making, based on streamlined, and more confined in-period adjustment criteria and assessments may relieve some of that regulatory burden.

22. Unison submitted on the Process and Issues paper that a five-year IM term may be appropriate. The Commission has said that the term of the IMs is not within the scope of these decisions.[26] Unsatisfactory outcomes over a seven-year period will have too high a consequence on Aotearoa's progress toward net-zero. To provide greater certainty, it would assist if the Commission could provide more information about what IMs it intends to reconsider prior to DPP4.

PROMOTING INCENTIVES IN 'ENERGY EFFICIENCY' AND AVOIDING DISINCENTIVES

The Commission's approach

23. The Commission says in the CPPs and in-period adjustments paper that:[27]

2.9 Where we consider it relevant and where the s 52A purpose of Part 4 is promoted more effectively, we may have regard to:

…

2.9.3 promoting incentives and avoiding imposing disincentives for suppliers of electricity lines services to invest in energy efficiency and demand-side management, and to reduce energy losses, when applying Part 4 in relation to electricity lines services (per s 54Q of the Commerce Act);

24. The Commission's Decision-Making Framework paper[28] discusses the basis for 'certainty' under the Act and the continuum that applies in absence of the ability to provide absolute certainty:

2.15 However, some uncertainty remains inevitable. As the Court of Appeal observed in Commerce Commission v Vector Ltd*, "certainty is a relative rather than an absolute value", and…*

25. The Commission has taken the view that s 54Q is secondary to s 52A. In doing so, it assumes there is an implicit conflict in treating both as directing outcomes that are in the long-term benefit of consumers (evidenced by its use of "may" in paragraph 2.9 of the CPP and in-period adjustments topic paper quoted above).

Correctly applying s 54Q

26. Section 54Q has a unique quality in Part 4 because it includes an explicit constraint on the Commission's discretion.[29]

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[26] Decision-making framework paper, 13 October 2022.
[27] *CPP and in-period adjustment mechanisms topic paper, Part 4 Input Methodologies Review 2023-Draft decision*, 14 June 2023.
[28] Framework paper, 13 October 2022, [2.21].
[29] Section 54Q applies to Part 4, as a whole, as opposed to subpart 9 (which addresses electricity lines services in particular).

54Q Energy efficiency

*The Commission must promote incentives, and **must avoid** imposing disincentives, for suppliers of electricity lines services to invest in energy efficiency and demand side management, and to reduce energy losses, **when applying this Part** in relation to electricity lines services.*

[Emphasis added]

27. Contrary to 'certainty' in s 52R of the Act, it is difficult to perceive the word "avoid" as being intended to be placed on a continuum or balanced as a relative rather than an absolute value. The Commission's position (responding to industry submissions on the relevance of s 54Q) is that:[30]

    2.30 We agree we must give effect to section 54Q in our decision-making on the IM Review, however, we remain of the view that we must do so in a manner that is consistent with promoting the outcomes of the section 52A purpose of Part 4.

28. The strength of statutory language matters and "*must avoid*" can be interpreted by its ordinary meaning *"not allow"* or *"prevent the occurrence of"*.[31] In doing so, there is no obvious conflict between meeting the more general intentions set out in s 52A and implementing the specific direction in s 54Q. That position is consistent with the Commission's description of the Supreme Court's interpretation of the role of s 52A within the Act:[32]

    2.34 As the Supreme Court has made clear, we must exercise our powers within the scope of our legal framework and make decisions to promote the Part 4 purpose. The pursuit of another purpose will not invalidate the exercise of those powers if the statutory purpose is being pursued and the statutory policy is not compromised by the other purpose.[44]

29. Pursuing the outcome in s 54Q (promoting incentives to invest) and complying with the directive (to avoid disincentives to invest) is not the equivalent of pursuing another purpose, nor does it compromise the s 52A purpose.

Interpretations available

30. The contrasting interpretations of Part 4 and the role of s 54Q are:

    a) *The Commission's approach* - The Act downgrades s 54Q as a discretionary consideration for the Commission that can be overridden by promoting s 52A. That approach requires justification of why ss 52A and 54Q cannot be interpreted consistently. It leaves s 54Q adding very little to s 52A

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[30] Framework paper.

[31] *The Environmental Defence Society Inc v The New Zealand King Salmon Limited & Ors* [2014] NZSC 38, [96].

[32] Framework paper: the Commission relies on *Unison v Commerce Commission* [2007] NZSC 74 which does not interpret the role of an "avoid" section in the Act. In fact, Section 54Q can be viewed as a specific limit, or constraint on discretion, on a broader power in s 52A. The Supreme Court helpfully explained:

- [54] *"Ascertaining the purpose for which a power is given is an exercise in statutory interpretation which is not always straightforward. This is partly because legislative regimes differ in the specificity with which they grant powers. In this area the courts are concerned with identifying the legal limits of the power rather than assessing the merits of its exercise in any case. They must be careful to avoid crossing the line between those concepts."*
- [57]: *"Section 57H contains no explicit directions to the Commission in relation to how it should assess business operations against thresholds in order to identify those businesses in breach. That clearly is a matter that is left to the Commission. In determining whether an identified business is to be subject to price control, however, the Commission is directed to take account of the statutory purpose."*

Section 54Q was inserted into the Act on 1 April 2009, following the Supreme Court's judgment discussing legal limits.

and Part 4 for suppliers of electricity lines services; an odd Parliamentary intention given its unique specificity.

b) Parliament intended the two sections to complement one another. Section 54Q supports s 52A(1)(a) and (b) by providing more detail on what will strike the appropriate balance with s 52A(1)(c) and (d) in the long-term benefit of consumers, and explicitly what will not. That is, avoiding disincentives in energy efficiency, demand side management and reducing energy losses is consistent with correctly balancing the s 52A outcomes.[33]

Meaning of 'energy efficiency' and existing Part 4 regulation

31. The Act or existing IM Determination does not internally define *energy efficiency*, but helpfully, the Energy Efficiency and Conservation Act 2000 (**EECA**) does (enacted well before the insertion of s 54Q into the Act):[34]

    Energy efficiency means a change to energy use that results in an increase in net benefits per unit of energy

32. Further analysis into what "net benefits" relates to can be taken from the purpose and sustainability principles in s 6 of the EECA.[35]

33. Unison submits that Parliament must have intended section 54Q to insert into the Act the same meaning of "energy efficiency" as EECA. The correct interpretation and role of s 54Q is:

    a) Suppliers of electricity lines services must not be disincentivised from investment that will create *"a change to energy use that will result in net benefits per unit of energy"*.[36]

    b) To assess the 'net benefits per unit of energy' social, economic, and environmental factors, including emissions reduction are relevant.

    c) The energy system in total needs to deliver on the 'net benefits per unit of energy'. Where electricity is determined to be to the 'net benefit' of society, distribution is critical and the end of a chain.

    d) EDBs must invest prudently, which requires adopting the best long-term solution. For example, facilitating upgrades to enable more Distributed Energy Resources (**DER**) (solar and EV load) and

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[33] Legislation Act 2019, s 10(1): The meaning of legislation must be ascertained from its text and in the light of its purpose and its context. Coupled with the common law rule "*generalia specialibus non derogant*, meaning that general provisions do not override specific ones", see Statutory Interpretation in the Supreme Court, Justice Susan Glazebrook, DNZM, https://www.courtsofnz.govt.nz/assets/speechpapers/sisc.pdf.

[34] Section 3. Section 54Q: inserted, on 1 April 2009, by section 4 of the Commerce Amendment Act 2008 (2008 No 70).

[35] Sections 5 and 6 EECA: *5 Purpose: The purpose of this Act is to promote, in New Zealand, energy efficiency, energy conservation, and the use of renewable sources of energy.*
6 Sustainability principles: In achieving the purpose of this Act, all persons exercising responsibilities, powers, or functions under it must take into account—
(a) the health and safety of people and communities, and their social, economic, and cultural well-being; and
(b) the need to maintain and enhance the quality of the environment; and
(c) the reasonably foreseeable needs of future generations; and
(d) the principles of the Treaty of Waitangi.

[36] Clearly relevant to the Part 4 mechanisms in the Act that apply to suppliers of electricity lines services (currently the IMs, DPP, CPP and Information Disclosure regimes).

process heat conversions because the change to electricity increases the net benefits per unit of energy (compared to the previous energy used).

e) The best long-term solution may require operational expenditure (**opex**), including procuring flexibility services, and / or asset replacement, renewal or the construction or development of new assets (capital expenditure - **capex**).

34. The Information Disclosure Determination defines *demand-side management* and refers to operational expenditure (**opex**) relating to energy efficiency.[37] There is no recognition of energy efficiency separate to demand side management. This ignores the EECA definition of energy efficiency. If the Act was intended to have a separate meaning, Parliament would have defined it.

Consistency between implementing s 54Q and meeting the s 52A purpose

35. The Commission has not read s 54Q and s 52A consistently, nor has it demonstrated why the sections conflict such that s 54Q must be subordinated. In our opinion, the correct interpretation accepts that the regulatory mechanisms under Part 4 must both:

a) protect the s 52A outcomes (including limiting excessive profits); and

b) ensure there are no disincentives to invest in energy efficiency, demand-side solutions and reducing energy losses (as a subcomponent of s 52A(a) and (b) incentivising efficiency and innovation), as well as promote incentives in those s 54Q matters.

36. To meet the s 52A purpose and appropriately balance the listed outcomes, the Draft IM Decisions need to ensure there are genuine incentives to invest and resolve the disincentives to invest, in accordance with s 54Q.

THE DISINCENTIVES TO INVEST INCLUDED IN THE DRAFT IM DECISIONS

EDBs prudently investing 'in a change to energy use to increase net benefits per unit of energy'

37. As addressed in the critical context above, there is sufficient policy certainty about investing in electricity solutions (which will vary between network and non-network solutions) and the 'net benefits [of electricity] per unit of energy' on the path to the net-zero target. For example, initiatives to facilitate large

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[37] Electricity Distribution Information Disclosure (Targeted Review Tranche 1) Amendment Determination 2022, Schedule 16: *means, in relation to expenditure, expenditure on assets or operational expenditure where the primary driver is to improve the efficient provision of electricity line services by-*

(a) improving energy efficiency, including by increasing the amount of energy services consumed or able to be consumed per unit of energy input;

(b) encouraging demand side management, including by managing consumers' rate or timing of electricity consumption; or

(c) implementing initiatives that reduce electricity losses;

(d) implementing initiatives that reduce reactive power flows in the network.

public EV charging 'hubs' at regular intervals on well used highways.[38] The Commission recognises in its *Financing and Incentives topic paper*:[39]

> *"Ensuring that regulated suppliers have incentives to innovate, invest and operate efficiently[3] is perhaps more important now than at any point since Part 4 of the Commerce Act 1986 (the Act) was introduced."*

38. With the right regulatory incentives and disincentives in place, the investment decisions of a prudent EDB, whether capex or opex, will support a 'change to energy use that increases net benefits per unit of energy'.[40]

The materially adverse impact of the price limit on Unison's price-path

39. The 'Big 6' price-regulated (or non-exempt) EDBs jointly commissioned Frontier Economics (**Frontier**) to provide expert evidence on the future impact of the existing 10% price limit,[41] a necessary step to understand the material effect of the IMs on Unison's price-path.

40. The Draft IM Determination includes a 'revenue smoothing limit' that is defined as:[42]

> *a maximum limit on revenue (excluding recovery of pass-through costs) specified by the Commission in a DPP determination or CPP determination.*

41. The mechanism lets EDBs draw down the wash up *"by an amount specified by the Commission in a DPP determination…"*, within the constraint of the revenue smoothing limit.[43] Both components of the revenue smoothing limit that will have a material effect on EDBs price paths are left for the DPP to determine.

42. The existing 10% price limit was introduced to mitigate price shocks (envisaged by s 53P(8)(a)). Frontier's modelling concluded that the 10% price limit may 'bind' (be reached and prevent recovery of efficient costs) in DPP4 and 5, even with the passing-through of transmission charges.[44]

43. The main issue with the price limit is the material effect on EDBs ability to recover their efficient costs because (quoting Frontier):
    a) *"…binding price limits could prevent timely draw downs of the revenue wash-up account, resulting in an accumulation of historical under-recoveries that might persist for several regulatory periods, and may eventually have to be written-off altogether."*[45]
    b) *"if the under-recovery is sufficiently large, the resulting regulated cash flows available to the EDB may be too low to support the benchmark credit rating at the benchmark gearing level—in which case the EDB may face a financeability constraint that prevents it from attracting sufficient capital to invest in regulated assets.";*[46]

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[38] The Ministry of Transport consulted on a proposal to include large EV charging hubs every 150km – 200 kms on 'main highways' earlier this year.
[39] *Financing and incentivising efficient expenditure during the energy transition topic paper (**Financing and incentives topics paper**)*, 14 June 2023, at pg 7, footnote 3 in the quote is: s52A(1)(a) and (b) of the Act.
[40] If the Commission is concerned about justifying 'energy efficiency', it should engage with policy-makers and EDBs about pragmatic ways to demonstrate that legislative definition is met.
[41] *Frontier Economics, A review of the limit on EDB price increases*, 13 July 2023.
[42] Draft IM Determination, 1.1.4(2), pg 56.
[43] Draft IM Determination, 3.1.4(5)(a), pg 108.
[44] Ibid, [14] and [83].
[45] Ibid, [121].
[46] Ibid, [126.]

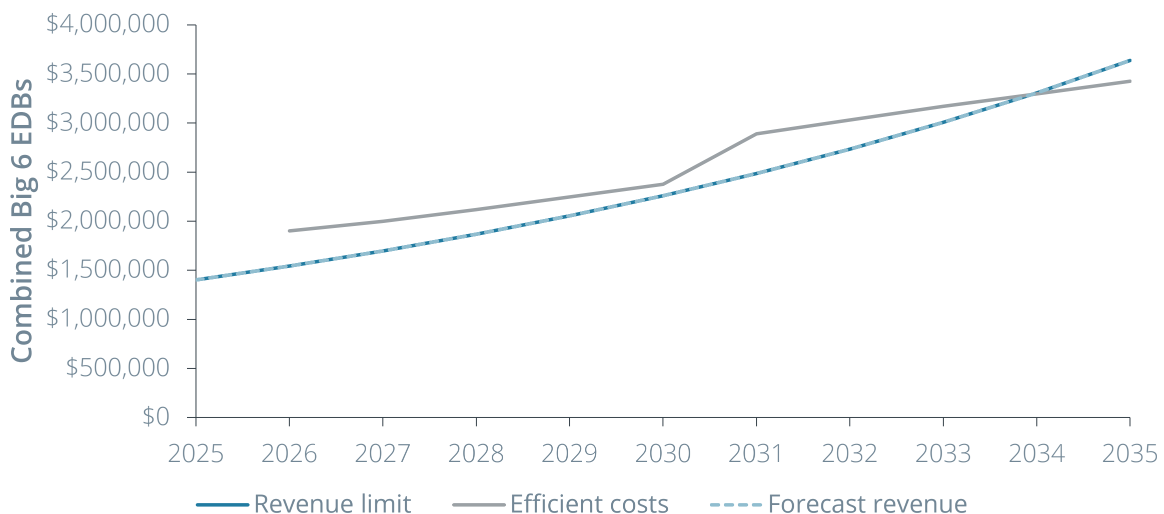
c) *“The incentives for cost efficiency and quality improvements created by these incentive mechanisms would be weakened significantly if EDBs could not access the financial rewards associated with lifting cost efficiency and quality performance.”*[47]

44. Three significant factors influence Frontier’s conclusion that the price limit may bind, that is: the impacts of actual inflation on the Regulatory Asset Bases of EDBs,[48] including in DPP4 if it remains high;[49] the WACC methodology and high Government bond yields; and the large investment needs of EDBs outlined in their recent Asset Management Plan forecasts.[50] The conclusion is that:[51]

    “*the more appropriate solution would be to allow customers in each regulatory period to pay the efficient costs of using regulated services—no more, and no less”*.

45. Frontier’s modelling aggregated the Big 6 forecast opening RAB’s to 2033, explained in section 4.4.1, including the Figure 4 extract below showing the impact of the revenue limit on the recovery of efficient costs:[52]

Figure 1: Forecast revenue comparison ($000s nominal)



46. Unison considers that Frontier’s report and modelling highlights:
    a) financeability concerns from the Big 6 are valid;
    b) where the risk is likely to bind, there is no ability to gain the benefit of IRIS incentives;
    c) the intent of some in-period adjustments are undermined if the price limit prevents recovery of eligible expenditure;
    d) without pass-through transmission costs, the limit would more frequently and consistently bind;
    e) there is a material risk that the price limit will be a disincentive to invest; and

[47] Ibid, [130].
[48] Ibid, [87].
[49] Ibid, [89.
[50] Ibid.
[51] Ibid, [139].
[52] Ibid, [147].

f) the difference between the Commission's intent in introducing the price limit, to minimise price shocks, and its potential effect on EDBs price-paths in DPP4, to prevent the recovery of efficient costs.

47. Frontier's assessment is that "…*$1.5 billion of revenues could be left unrecovered by the end of the DPP4"*.[53]

WACC reduction and methodology

48. The Commission released a high volume of detail on 14 June 2023 about its approach to reducing the WACC to the 65th percentile and decisions about components that contribute to the WACC calculation. The stability and predictability of the WACC percentile is particularly important to promote incentives to invest and reduce the risk of underinvestment in a regulated industry.

49. The long history of contention around the appropriate WACC illustrates the industry's concern with a downward trend that does not fairly recover the cost of capital. Without re-hashing previous arguments, the existing 67th percentile is conservative, reflected by the Commission's ability to confidently conclude:[54]

> *3.198 We reiterate our view that our current approach limits excessive profits, consistent with s52A(1)(d).*
> [Emphasis added]

50. It is difficult to see what problem the Commission is fixing by reducing the WACC given it has limited excessive profits. Climate change will have an increasingly macro impact. Experiences like Covid, and severe weather events have contributed to the "catch-up phase' discussed in Unison's strategic priorities at paragraph 8(a) above.

51. There is a clear conflict between the Commission reducing the already conservative WACC percentile further and the evidenced impact of climate change, and other uncontrollable events, on the electricity market in the next decade. The reduction seems to reflect that the Commission is more risk-tolerant toward under-investment in a critical investment period for Aotearoa, without sufficient evidence of a reduced risk of under-investment. The impact is increased disincentives to invest and a corresponding increase in the risk of under-investment.

52. Oxera has prepared a report responding to WACC and the volume of expert evidence, modelling and topics papers released by the Commission on 14 June 2023, alongside its Draft IM Determination.[55] To navigate the detail released by the Commission at one time, the Big 6 were required to commission Oxera to evaluate the expert evidence and reasoning provided. Unison supports the criticisms and

[53] Ibid, [150].
[54] *Financing and incentives topic paper,* 3.198.
[55] Oxera, *Response to the New Zealand Commerce Commission's draft decision for Part 4 Input Methodologies Review 2023 on the cost of capital, prepared for the New Zealand electricity distribution businesses (**Oxera report**),* 19 July 2023.

approaches outlined in that report and considers that they will result in materially more certain and better Part 4 outcomes, founded in stability and predictability.

Financeability

Material effect

53. As discussed in the critical context above, the Commission recognise that *"incentives to innovate, invest and operate efficiently are perhaps more important now than at any point since Part 4 of the Commerce Act 1986 (the Act) was introduced"*. EDBs are therefore left with an unprecedented tension. How will they resolve the inability to recover efficient costs (price limit constraints), short-term cash flow issues, and invest at the pace and scale to meet consumer demand. Investors need a reasonable expectation of a return consistent with the benchmark operating assumptions. Oxera address the Commission's implication that foregoing dividends will not have consequences.[56] The adverse consequences of disincentivising investment does not promote Part 4 in a critical period of investment.

Discussion

54. In response to financeability concerns, the topic paper says:[57]

> *X14: EDBs that face particular challenges, including financeability risks, can apply for a customised price-quality path (CPP) that better meets their particular circumstances and provides scope for, among other things, an alternative depreciation approach that better promotes the Part 4 purpose.*

55. The Commission have rejected a financeability test in the IMs and the indexation of EDBs RABs.[58] The Commission state that:

> *"While all suppliers can in principle raise debt and equity, their ability to do so in practice will depend on their specific circumstances".*[59]

56. Speaking about the ability of a *"prudently financed supplier meeting both their debt obligations and the costs of new investment"*, the Commission say:[60]

> *"An efficient supplier operating under our benchmark assumptions is unlikely to face financeability issues, given the way our regulatory accounting is consistent with real NPV=0 over the expected life of the assets.*[62]

57. Frontier's modelling provides a contrasting scenario to the Commission's conclusion, given the price limit may leave the Big 6 without the short-term cash flows to service debt and attract the investment that is required to meet consumer demand (paragraph 43.b) above). The *"specific change in circumstances"* is the need for EDBs to invest in the decarbonisation of Aotearoa, compounded by the impact of a further reduced WACC.[61]

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[56] Ibid, [8.18].
[57] *Financing and incentives topic paper*, pg 8 [X39].
[58] 3.37 and 3.2
[59] 3.291.
[60] 3.27.1
[61] Ibid, 3.291: *"We note that 'ability' to invest is not the same as 'incentive' to invest. The potential inability to invest can be caused by a range of factors, which may result in the supplier operating in a way that is inconsistent with the benchmark operating assumptions."*

58. Indexation as an approach to financeability concerns is strongly rejected by the Commission, and other tools are considered appropriate such as reducing a dividend payment to raise debt and / or equity.[62] The conclusion is: [63]

> "*We would only bring forward capital recovery in specific circumstances where we are satisfied that doing so would better promote the Part 4 purpose.*"

59. Oxera address financeability and equity issuance costs (as related issues) and include: [64]

> *"Other reasons why a benchmark company with a regulatory package that follows the NPV = 0 principle may encounter financeability challenges are related to cash-flow misalignments. In other words, if the timing of cash outflows and inflows is not sufficiently aligned, the company may need to secure a significant amount of financing, which may or may not be possible to do on reasonable terms. This is more likely to be problematic in high-growth phases where CAPEX outflows are fairly high relative to the depreciation allowance. The misalignment of CAPEX and regulatory depreciation allowance cash flows is acknowledged by the NZCC."*

60. Oxera address the Commission's concerns about a financeability test, including the impact of non-regulated activities on a company's regulated activities:[65]

> *"However, we explain below that regulatory determinations also play a big role in companies' financeability. Therefore, it is important that the NZCC looks at the drivers of a financeability problem, if it is identified, and undertakes an assessment of whether any such problems are due to company specific inefficiencies or suboptimal financial decisions, or if they arise <u>due to low regulatory allowances</u>."*
> [Emphasis added]

61. Oxera propose:[66]

> *"To overcome the challenges of running a financeability test only at the stage of setting price quality paths, as described above, the NZCC could follow at least one of these two options:*
>
> - *at the stage of the IMs review, commit to undertake a financeability test at the DPPs, CPPs or IPPs and set up the framework of the financeability test that the NZCC will follow, to provide networks with certainty. According to the NZCC, providing certainty is the purpose of the IMs;*
> - *undertake a financeability assessment using provisional cash flow forecasts when reviewing the IMs. This would be done as a provisional check in a stylised way, before going through the more tailored and detailed financeability testing that the NZCC states that it currently goes through on a case-by-case basis. We consider this approach to be sufficiently practical, given that networks provide the NZCC with their updated CAPEX and OPEX forecasts annually,[158] which ensure that the NZCC has the required data for the financeability test."*
>
> *"Either option would allow one to test whether the regulatory package allows companies to finance their operations on reasonable terms and have the capacity and capability to manage their financial affairs."*

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[62] Ibid, 3.37.
[63] Ibid.
[64] *Oxera report*, [8.11].
[65] Ibid, [8.6]: *"In practice, this challenge tends to be navigated by regulators by undertaking financeability testing for a benchmark (efficient) regulated network, not accounting for the impact of non-regulated activities or company-specific factors such as financing decisions or cost efficiency and quality incentives performance."*
[66] Ibid, [8.14] and [8.15].

62. In respect of equity issuance, Oxera explain the correlation with a financeability assessment:[67]

> *"The process of establishing the equity requirements for a benchmark company is closely related to the financeability assessment—debt financeability issues can be remedied by dividend reductions and equity injections. But these potential remedies come at the expense of equity financeability. Ensuring that equity requirements are met provides another reason for introducing financeability testing."*

63. What is not clear from the Commission's reasoning is the harm of inserting a financeability or equity issuance test into the IMs. The Commission has confirmed it can, and has, considered financeability (so the only downside appears to be restricting the Commission's discretion by providing certainty that it will be addressed – as envisaged by s 53P(8)(a)).[68] It is also unclear what Part 4 outcomes weigh against providing certainty about alleviating the financial hardship of EDBs, yet balance in favour of certainty to minimise price shocks (also envisaged by s 53P(8)(a)).

64. There is UK precedent for both using a "benchmark regulated network" to undertake a financeability test and aiming up on the cost of equity.[69]

Conclusion

65. To resolve this unprecedented tension at a critical time, the Part 4 purpose will be promoted by a safe harbour that embeds:
    a) a financeability test; and
    b) an equity issuance test.

Incentives - IRIS

66. The Commission's topic paper says:[70]

> *X46 Our draft decision is to keep the current approach to expenditure incentive mechanisms for EDBs (opex and capex IRIS) ... We have considered alternative approaches that would simplify the approach to expenditure incentives but consider that the current approach better achieves our IM Review overarching objectives. This draft decision should be considered with our proposed amendments to the current expenditure incentive mechanisms for EDBs and Transpower.*
>
> *X52.2 Submitters suggested that we exclude some expenditure categories from IRIS. We do not consider that this would better achieve our IM Review overarching objectives because it would remove incentives for efficiency, and, under IRIS, suppliers only bear a proportion of any overspends (ie, they are not exposed to the total over- or underspend over the life of the solution, anyway). If these costs were treated as a recoverable cost (as suggested in submissions), it could create significant price volatility.*

67. The complexity of IRIS is accepted; adding to the complexity is far from preferable. However, Unison is concerned with the compounding disincentives to invest, including the risk of financial penalties for prudent investment that will contribute to decarbonisation.

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[67] Ibid, [8.22].
[68] *Financing and incentives topic paper,* 3.291.
[69] *Oxera report*, [8.13] and [8.21].
[70] *Financing and incentives topic paper*, pgs 14 and 15.

68. The level of complexity that is acceptable will equate to the value it adds to promoting the Part 4 outcomes. In respect of potential complexity or material simplification, it would assist to be provided with more information about the implementation of the proposed ‘bucket’ approach to the wash-up mechanism (consolidating each wash-up balance).[71]

69. Fit-for-purpose in-period adjustments are crucial to the effectiveness of the IRIS, and its consistency with s 54Q and the Part 4 purpose. There must be a mechanism for EDBs to respond to incremental network growth that promotes investment in energy efficiency and demand side management for the long-term benefit of consumers. That is, investing in the change to electricity use to increase the net benefits per unit of energy. Prudent asset management decisions for this purpose must not result in financial penalties.

70. To restore the promotion of the Part 4 purpose through the IRIS, amendments are required to rectify adverse impacts and provide ‘safe harbours’ to respond to significant risks and disincentives to invest. At a minimum, the final IM Decisions should:
    a) maintain the 67th percentile of the WACC;
    b) resolve the impact of the price cap on a critical investment period;
    c) embed financeability and equity issuance tests;
    d) include clearer and more fulsome in-period adjustments to provide for the resolution of key uncontrollable risks; and
    e) provide certainty that the cost of a CPP will be fully recoverable in prices (addressed below).

RELATED AND OTHER MATTERS

In-period adjustments: incremental network growth, risk events and rejection

Incremental network growth

Material effect

71. The Commission considered three mechanisms to respond to the forecasting challenges into the next DPP period, including:
    a) Contingent allowance mechanisms;
    b) Use it or lose it allowances; and
    c) Quantity wash-up mechanisms.

72. The Commission did not consider any of the options above would more effectively promote the Part 4 purpose or be consistent with the purpose of relatively low-cost DPP regulation, as specified in s 53K of the Act. EDBs are therefore still faced with uncontrollable risks in DPP4 and 5 that will potentially require delay of prudent investment.

73. To balance the s 52A outcomes consistently with s 54Q, the final IM Decisions need to provide the potential for an in-period adjustment for incremental network growth, including system growth capex that is not related to acquiring flexibility services or connection capex. As discussed above, the Act provides

[71] *Financing and incentives topic paper, Appendix D,* [D42].

no certainty that multiple CPP applications can be processed in one year, and if a CPP is delayed, the price limit undermines certainty in the recovery of efficient costs.

Discussion

74. The Commission is aware of the risk of load presented by EV charging. EV uptake is difficult to predict and is likely to have different regional impacts. Government or regulatory rules that assist to manage demand are also outside of EDB's control (for example, requiring off-peak charging of EVs).

75. In the present environment, EDBs need to be assured that where the demand exceeds reasonable forecasts, and where demand-side management cannot resolve the constraint in the medium to long-term, the IMs embed a fit-for-purpose response. Without a safeguard, EDBs may be left facing unfeasible reprioritisation decisions trading off: prudent asset management (maintenance and repair), connecting other large loads being electrified (like process heat), or rectifying upcoming constraints to meet foreseeable consumer demand. Solutions may be limited to what 'bucket' allowances are left in (capex or opex), as opposed to what is the best solution for the constraint. Such an outcome would conflict with promoting the Part 4 outcomes and likely disincentivise investment in the best long-term solution.

76. As explained in Unison's December 2022 submission on expenditure forecasting,[72] Unison has responded to this foreseeable risk based on scenario planning that ranges from conservative to aggressive. However, in an aggressive uptake scenario, Unison may be required to plan and implement solutions earlier than expected. 'LV visibility' can monitor potential pinch points of the network where demand is expected to reach a constraint first. Hypothetically, for example, stage one information gathering can utilise DER (solar and EV) tracking to understand demand, stage two can use smart-meter data to follow whether there is increasing use in a suburb, stage three can implement LV monitoring at 70% capacity, and say, at 100%, a solution can be 'triggered'. That trigger point will require a prudent EDB to resolve the upcoming constraint. As the Commission will be aware the solutions will be:
    a) buy a flexibility solution to shift demand at peak times;
    b) buy a flexibility solution to shift demand at peak times temporarily and extend the timeframe to align with a planned upgrade (scheduled based on the condition of the asset);
    c) bring the upgrade of the asset earlier in the work programme to avoid the cost of a) when a prudent investment is required of the asset in the medium term; or
    d) implement an innovative or non-traditional solution.

77. While some smaller scenarios will be able to be re-prioritised, policy or rapid social change could influence multiple 'triggers' and upcoming constraints realised in DPP4 and 5. Without an in-period adjustment available for system growth capex, the material effect on Unison's price-path could be significant and constrain the ability to implement the best long-term solution.

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[72] 16 December 2022.

78. The broadened reopener mechanism in the Draft IM Decisions includes in the *foreseeable large project* criteria, system growth expenditure. System growth expenditure[73] (as defined) responds to a) to b) above but it does not respond to c) unless it is system growth capex that is incurred to acquire flexibility or connection capex (which requires the request of a connecting party). D) is unknown.

79. The criteria also require the project or programme to be included in the AMP sufficiently justifying the need. This raises several gaps and risks, explained below, to network planning and exceeding allowances:
    a) The definition of programme leaves some confusion ("means a group of related projects with a common purpose"). Is addressing incremental network growth at different points of the network, a common purpose?
       If not, how will an EDB fund multiple prudent upgrades that individually sit below the threshold (at least $2.5 million for Unison).[74]
    b) How are EDBs going to fund incremental network growth where the best long-term solution is only system growth capex?
    c) If programmes of work can incorporate multiple projects relating to incremental network growth will 'bundling' projects in this manner incentivise EDBs to wait for multiple triggers and constraints to be reached so the criterion for an equivalent allowance is met?
    d) How is resourcing going to fit the timeframes for work that are being driven by the in-period adjustment mechanisms and criteria?
    e) It may have been reasonable for the AMP to exclude the projects (because there was no upcoming constraint known), validated by previous independent checks of the asset management plan.[75] Reasons for rapid growth could be:
       i) policy decisions resulting in rapid electrification of households, transport or business;
       ii) organic growth responding to an event, greater disposable income, decarbonisation choices; or
       iii) an external innovation that impacts electricity use and the market.

80. The Commission reason their rejection of contingent project allowances as:[76]

    We consider the incorporation of new contingent expenditure allowances as recoverable costs would not more effectively promote the s 52A purpose. It would be likely to reduce the incentives on suppliers to actively manage their costs. As discussed further below, the expansion would not be consistent with the purpose of relatively low-cost DPP regulation, as specified in s 53K of the Commerce Act.

81. However, there is subsequently no provision in the Draft IM Decisions for incremental network growth where the best long-term solution is system growth capex (unrelated to acquiring flexibility).

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[73] means: (a) system growth capex; or (b) opex (i) for which the primary driver is a requirement for additional capacity at a particular location; and (ii) that is <u>incurred to acquire flexibility</u>;..
[74] Draft IM Determination, cl 4.5.10(3).
[75] The approach taken by the Commission for the 2023-2033 AMPs.
[76] *CPP and In-period adjustments paper*, [9.53]

Conclusion

82. To resolve the residual conflict with s 54Q, and promote the s 52A outcomes, there needs to be, at a minimum, an in-period adjustment mechanism that provides additional allowances to invest in projects and programmes of work that are related to system growth capex (only).

83. From an administrative and resourcing perspective, incremental network growth can be evidenced by monitoring. Generic evaluations of what is the best long-term solution can be developed, providing consistency between EDBs and a simple evidentiary basis for the Commission's assessment.

84. Provision for a system growth capex reopener event would provide more certainty and promote materially better Part 4 outcomes compared to failing to provide for one of the biggest risks to EDBs in the upcoming regulatory periods. Other solutions may also be acceptable if they rectify the risk to Unison without unintended consequences.

85. It is difficult to identify the harm of potential over-investment in providing for system growth capex that can be justified by clear evidence. If successful other regulatory mechanisms control load, such as by mandating controllable EV charges, or otherwise implementing demand side management techniques, EDB monitoring will evidence slowed down or stagnant demand due to effective external controls.

Risk event

86. The Draft IM Determination include as a reopener event, a 'risk event'. This is deterioration of a network asset or their immediate surrounds, that otherwise meets the criteria in cl 4.5.11. Included in the criteria is:

    "(1)…(a) the deterioration has occurred, or the EDB has demonstrated, based on a probabilistic risk assessment, that the deterioration is likely to occur;

    (b) the deterioration has (or will have) one or both of the following effects:

    (i) a materially adverse effect on the EDB's ability to meet its quality standards under the DPP;

    (ii) an effect that compromises safety for any person, any equipment, or the network;

    …

    (d) taking steps to remedy the deterioration-

    …

    (ii) <u>cannot be delayed until a future DPP regulatory period without one or both of the effects described in paragraph (b);</u> and"

    [Emphasis added]

87. It is unreasonable to expect EDBs to demonstrate (noting the "probabilistic risk assessment") that an effect is likely to impact quality standards within one regulatory period, which may differ between four years and 11 months and one month. Where a deterioration is identified and it is considered to meet (i) and (ii) of (b), a precise timeframe is an unrealistic requirement. The emphasis should be on whether a prudent EDB would rectify the risk. It would undermine the intent of the reopener to unduly constrain its use to an impractical engineering standard.

Residual discretion to reject a reopener event because a CPP is more appropriate

88. The Commission has removed the existing $30 million cap on reopener events that relate to major capex projects in a regulatory period. This was demonstrably necessary to facilitate the pace and scale of upcoming work for EDBs.[77] However, the Commission has proposed a new general power to decline to reopen the price path because it considers *"a CPP proposal is more appropriate than amending the DPP…"* as set out in cl 4.5.14 of the Draft IM Determination. Five inclusive matters are listed, however, the Commission may have regard to any matter it considers reasonable.

89. The main issue is insufficient detail raising uncertainty. Commercial arrangements and negotiations do not align with regulatory processes. Uncertainty about the circumstances for an eligible reopener will make commercial negotiations more difficult. The Commission has full discretion to determine the allocation of cost for a CPP.[78] The high costs, resourcing requirements, and extended periods of time required for a CPP (evidenced by other EDBs applications) creates a high risk. Following rejection, if a CPP is required, an EDB may end up in a materially worse position under the contract, by absorbing some, or all, of the cost of a CPP application (as opposed to having certainty that can be recovered through prices).

90. More precise criteria to constrain the Commission's discretion is sought and clarification about:
    a) When the Commission intends to use its statutory prioritisation power in s 53Z. This creates uncertainty about whether an EDB can efficiently have the price-path remedied to address their circumstances (appreciating the claw-back approach in prices).
    b) Lack of certainty about how the Commission will decide what CPP application costs are recoverable through prices (when it is relied on as a safety net).[79]

Single-issue CPP

91. The Commission concludes:

    3.40 In the 2016 IM Review we concluded that CPPs should always be full scope and that we did not consider single-issue CPPs to be appropriate.[45] A "single-issue CPP" would be a reduced-scope CPP (compared to a regular CPP) where customisation is sought only in respect of one part of the supplier's DPP, which could be a single project or several projects that make up a programme of work. The single-issue CPP would attract wider scrutiny than a DPP reopener but narrower scrutiny than a full scope CPP.

    3.41 The issue we have considered in this IM Review is whether there is a gap in the regulatory continuum that is not covered by DPP reopeners or a regular CPP.

92. Unison considers there are gaps in the regulatory continuum relating to the price cap, financeability, incremental network growth and the impact of financial penalties resulting from prudent investment. Providing a single-issue CPP with clear criteria and process requirements could be a more certain and

[77] Unison's submission *EDB expenditure forecasting*, 16 December 2022.
[78] Section 53Y(2).
[79] The Act provides the Commission the power to exercise it discretion under s 52Y(2), but it would promote s 52R to clarify how it will exercise that discretion.

lower cost regulatory mechanism that responds to the inadequacies identified in the DPP and CPP methods discussed.

Insurance

Material effect

93. The Commission has increased the allocation of risk to EDBs who suffer a catastrophic event by increasing the previous threshold to match the new generic reopener event thresholds, as applied to Unison, the lesser of: 1% of the FNAR of a regulatory period or $2.5 million for Unison. Consistent description of the thresholds for eligibility, or replacement with one definition of a “reopener expenditure threshold”, would assist to clarify the determination.

94. The main issue is that there is an increase in the risk of severe weather events and natural disasters allocated to EDBs. Without pass-through insurance costs, this could result in adverse outcomes after an event. Unison’s perspective after Cyclone Gabrielle is that it is difficult to accept that charging heavily impacted consumers significantly more money for distribution services after an event is in their long-term benefit (recognising there is also a constraint to do that, in the absence of a CPP, because of the price limit). Incentivising pass-thorough insurance on reasonable and commercial terms would create a materially better Part 4 outcome.

Discussion

95. To address the costs incurred responding to Cyclone Gabrielle, the Commission has engaged with Unison about its intention to apply for a catastrophic event allowance and reopener. Unison understands there are nuances of legal interpretation to be discussed. What is clear to-date is that there is a misalignment between commercial insurance processes (largely out of an EDBs control) and the Commission’s resourcing, timeframes, and regulatory requirements (including constraints on pricing).

96. The resulting key risks for Unison are that: its efficient costs to responding to the severe weather event, meeting its lifeline utility functions, and rectifying its network, will not be permitted or able to be recovered through prices (where it is not reimbursed by insurance); and financial penalties will be imposed for expenditure that exceeds regulatory allowances during that period.

97. The Commission should mitigate those risks more effectively after a catastrophic event.

Conclusion

98. For the many reasons previously discussed, Unison does not agree that it will be able to absorb and re-prioritise greater risk in DPP4 and 5, due to the uncontrollable risks, material effects of a price limit, and the costs of servicing debt or funding equity to invest.[80] Insurance, if priced appropriately, can re-balance the outcomes, as does ‘ring-fencing’ or otherwise encouraging funds that will support future post-event costs (Unison’s self-insurance is referenced by the Commission). While Unison accepts there are some risks to passing-through insurance costs (that is, the risk of inefficient levels of insurance), cost allocation

[80] *CPP and In-period adjustments paper*, X52, pg 20 *“This better reflects our expectation of EDBs’ ability to reprioritise within expenditure allowances and changes to reopeners which would allow a greater set of costs to be included in a reopener application.”*

should better reflect the reality of circumstances that EDBs will face post-event and with more frequent severe weather events. Commercial insurance, unsurprisingly, is increasing in price and reducing in potential cover. Passing-through insurance costs would result in better Part 4 outcomes, subject to sensible parameters about what is a reasonable and commercial level of insurance in the circumstances – that is, the consumer is getting bang for buck for the mitigation of that risk.

Removing legal costs

Material effect

99. The Commission has decided to remove legal costs from operating costs.[81] This reallocates the risk of bringing appeals against the IMs completely to suppliers (as opposed to the existing ability to share that risk with consumers).[82]

100. The effect of the amendment will be that suppliers are required to decide whether they have sufficient short-term cash flows to fund a challenge and can re-prioritise commitments to absorb the cost, whether it is successful or unsuccessful.[83]

101. The main issue is that this amendment does not reflect the critical context. Consumers need climate change and energy wellbeing to be addressed by the Government and regulators. It is critical that regulated suppliers can continue to test the appropriate boundaries through a transformative period, including for consumer benefit. Whether successful or not, the appeal is likely to increase the maturity of the law and regulatory regime which will benefit the Commission, suppliers, and consumers.

102. The relevant law, regulation and market environment does not provide enough stability and predictability to justify reducing accountability of the Commission under the Act. As a result, this amendment disincentivises a supplier commencing a merits appeal to hold the Commission accountable for achieving the Part 4 outcomes, and statutory requirements relating to IMs.

103. Beyond the context addressed at the start of this submission, additional factors influencing change in the regulatory periods that the amended IMs will cover are:

    a) New and novel IMs that may have unintended consequences and given complexity are difficult to confirm are robust in the condensed timeframe;
    b) the rise of different competitive elements in the market;
    c) new and untested views of key stakeholders; and
    d) untested law (the interpretation 54Q).

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[81] This also applies to appeals to senior courts on any 'determinations' of the Commission, except for information disclosures and a DPP (which are excluded from an appeal right under those sections). A legal challenge against the IMs relates to whether an amendment to the Commission's decision will be *"materially better in meeting the purpose of this Part, the purpose in section 52R, or both"* provided by s 52Z(4).

[82] Through recovering the legal costs from consumers for an unsuccessful challenge or costs award that does not fully reimburse the supplier.

[83] A costs award infrequently covers 100% of the bill where the law and context is complicated and/or multiple parties are involved.

Discussion

104. The Commission's reasoning for the amendment includes limiting excess profits by preventing 'double-recovery', ensuring consistency with its risk allocation principle, better promoting the IM purpose in s 52R (certainty), and complying with the intent of s 52T(1)(c)(i) of the Act (specifying recoverable costs which may not include appeals).[84]

105. Resolving the identified problem of 'double recovery' (from both a costs awards and from consumers in prices) does not require removal of legal costs in total from operating costs. For example, a proportionate fix would be to exclude that quantum from operating costs i.e.: *the amount of legal costs that are not otherwise successfully recovered through a Court ordered costs award*.

106. Section 52T(1)(c) signals the foreseeability of a point in the life of the Act, and input methodologies where there is minimal legal uncertainty and mature regulatory mechanisms (when they are well tested and understood). Parliament also likely envisaged a steady-state market environment where regulation was founded on historical evidence. In those circumstances, holding the Commission accountable for promoting Part 4 in the long-term benefit of consumers may not require a strong accountability mechanism like sharing the cost with consumers.

107. Before amending the definition of operating costs as proposed, the Commission needs to first run an IMs process that gives suppliers and stakeholders adequate confidence it is and will continue to be robust. The current process raises the following concerns:

    a) Promoting the Part 4 outcomes requires finely balanced decisions, many of which rely on expert evidence, there has been no opportunity for expert conferencing to test differences and achieve alignment and limited or no prior engagement on complex and highly technical changes.[85]
    b) The confined timeframe to process, evaluate, and provide opinions on highly technical expert opinions can undermine open and fair engagement. Staged consultation on topic papers and expert opinions would enable the testing of differences and likely achieve better and less adversarial outcomes.
    c) The more complex the regulation imposed by the Commission, the higher the cost of the merits appeal will be. Costs awards do not recover the full amount of a complex legal challenge based on large volumes of information, expert evidence, and law.
    d) A successful appeal may not result in a costs award, or much of one.
    e) Suppliers have submitted about the short-term cash-flow issues they will experience under the amended IMs, which will likely extend to the next IM Review – removing recoverability of legal costs for a merits appeal heightens that concern.
    f) Stakeholders have minimal involvement until the Draft IM Decision stage, leaving suppliers unable to substantively prepare for those viewpoints before the Draft IM Decisions, and under a confined two-week deadline to do so.

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[84] *Draft decision Report on the Input Methodologies review 2023*, pgs 25 and 26.
[85] *Wellington International Airport Ltd & Ors vs. Commerce Commission* [2013] NZHC 3289, this is addressed in [164].

g) There will be a greater financial risk to supporting a decision of the Commission against a stakeholder or a challenge from another supplier (irrespective of the value of that methodology to the consumer).
h) The inability to recover costs from consumers does not match the reality of workably competitive markets where challenging the applicable law is able to be priced into the good or service.

Conclusion

108. The amendment will result in materially worse Part 4 outcomes and put EDBs in a position of choosing to hold the Commission accountable or spend constrained opex allowances. This will likely put further strain on investing in energy efficient solutions and demand side management.

Large connection capex

109. The new measure to remove large connection capex 10MW and over, agreed on commercial terms, is a valuable method of decreasing uncertainty, removing economic regulation due to a workably competitive market being at play (consistent with s 52 of the Act), and decreasing workload for the Commission and EDBs.

110. Unison assumes the intention is to leave EDBs with the flexibility to determine whether it is in the long-term benefit of consumers to fund the work entirely under a contract for service, or whether the value to other consumers justifies the EDB financing the work (and its inclusion in the RAB). Unison's approach to capital contributions takes into account when future consumers will benefit from sharing the network upgrade costs and Unison contributes accordingly.

111. It would assist to understand whether the Commission intends there to be options, such as:
a) The assets connect 10MW, but a portion of the assets are provided for under a separate contract that does not 'fully fund' those assets, and subsequently the non-funded assets are included in the RAB to return a cost over their life.
b) 'Splitting' 10MW or more contracts, where two contracts provide for different funding arrangements for portions of the assets. For example, in a 20MW application, 10MW may be entered into on purely commercial terms, and likely require higher upfront costs to manage the risk to the EDB of contracting with one party. A second contract may include more generous terms that enable the EDB to recover some of the cost from that party over time, as part of RAB, and provide for the EDB to contribute to a network upgrade (for the benefit of other consumers). The second contract would not be fully funded under the contract and the value of the assets would remain in the RAB.

112. The definition of "large connection contract" in the Draft IM Determination provides a threshold:[86]

"…*the EDB demonstrates <u>beyond a reasonable doubt</u> that the terms and conditions of the contract were arrived at following a process that provided opportunities for –*

i) *the EDB's affected customers to make or approve reasonable price-quality trade-offs; and*
ii) *the competitive provision of new electricity distribution services by parties other than the EDB."*

[86] Draft IM Determination, cl1.1.4, pg 38.

[Emphasis added]

113. If that threshold is retained, given the high burden of proof *"beyond a reasonable doubt"* inserts, the Commission needs to be clear what evidence it will require to satisfy it. "*Robustly demonstrates*" or *"on the balance of probabilities"* may more appropriately fit within the regulation than *"beyond a reasonable doubt"*.

CONCLUSION

114. The material concerns Unison has with the Draft IM Decisions are the correct application of s 54Q alongside the Part 4 purpose, and the significant in-period risks that remain.

115. Materially better Part 4 outcomes will be achieved by addressing those matters and embedding safe harbours to ensure:[87]
   a) a fair WACC at least at the (conservative) 67th percentile;
   b) efficient costs of prudent network growth and non-network decisions (the impact of the price limit) will be recovered;
   c) financeability and equity issuance concerns will be addressed;
   d) reopener events can mitigate the key risks, by addressing:
      i) incremental network growth at a faster rate than forecast (especially because of policy decisions driving consumer behaviour);[88]
      ii) risk events where a probabilistic risk is identified, but it cannot be proven that it will eventuate in the correlating regulatory period;
      iii) programmes of work will be catered for within the criteria; [89]
   e) reasonable timeframes and administrative requirements for processing applications;[90] and
   f) predictable criteria to assess whether a CPP is more appropriate than a reopener event;

116. Additional risks that, if mitigated, will achieve materially better Part 4 outcomes are:
   a) passing-through insurance costs;[91]
   b) providing for CPP costs to be fully recoverable; and
   c) reducing the potential for IRIS financial penalties to be imposed despite the investment contributing to Aotearoa's *"change to energy use that results in an increase in net benefits per unit of energy"*.[92]

[87] [214] HC: While the Court of Appeal clarified the continuum that certainty is subject to, the backstop in the Act is the ability to assess the materially effect on the supplier's price path as per s 52T(2)(a).
[88] Unison submission on *Price-Quality Path In-Period Adjustment Mechanisms Workshop*, 20 December 2022, question C2.
[89] The existing IM Determination defines programme as *"group of related projects with a common purpose"*. It is possibly a broad scope but subject to the Commission's discretion. It is unclear whether, for example, incremental network growth would be within scope if system growth capex was provided for by a reopener mechanism.
[90] Timing has specific relevance when IRIS penalties result from the disclosure year that expenditure relates to.
[91] Evaluated as reasonable and commercial.
[92] Consistent with s 54Q and the EECA definition of energy efficiency.

117. The Commission does not have an enviable task this IM Review and the detailed reasoning provided in the reports published is appreciated. However, it has been very challenging to assess the material effect on Unison's price-path given the volume of technical information provided at one time, with a five-week period for substantive submissions. This is compounded by other regulatory consultations during this Draft IM Decisions process (noting the upcoming two-week cross submission step).

118. Unison looks forward to stepping into the critical next decade with the benefit of regulation that incentivises energy efficiency and demand-side management and otherwise promotes the Part 4 outcomes for a better energy future. We appreciate the time taken to review this submission.